In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 292

ANTHONY M. REINACH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

This case presents the question whether a writer of "put" and "call" stock options who, in response to the exercise of some of the call options, made "short sales" of the stock called, rather than cover his position by immediate purchase in the market of the stock called, is entitled to deduct the resulting losses as ordinary rather than capital losses, and thus take advantage of the carryback allowed such ordinary losses.[1]

[1] Taxpayer's alternative contention (Pet. 10) that he should be allowed to deduct amounts paid to the broker-lender of the stock sold short, attributable to dividends declared on such stock, was not presented to the Tax Court or on the appeal from that court's decision. It was first raised in his petition for

The court below, affirming the Tax Court, held that the losses were deductible only as capital losses under Sections 1221(1) and 1233(a) of the Internal Revenue Code of 1954. Its decision is correct and there is no conflict or other occasion for further review by this Court.

1. Between March 1956 and August 1957, the taxpayer wrote 412 "put" and "call" stock options, of which 122 call options were exercised.[2] With respect to 96 of the exercised call options, taxpayer immediately purchased in the market the shares delivered to the optionee. As to the remaining 26, however, he went "short", borrowing from his broker the stock delivered to the optionee and then waiting for periods ranging from one year seven months to three and one-half years before purchasing stock on the exchange to cover his short position. Six of the 26 short sale transactions resulted in the losses here in issue. (Pet. A 3–5.)

Section 1221(1) of the 1954 Code excludes from the category of capital assets property held by the taxpayer "primarily for sale *to customers* in the ordinary course of his trade or business". (Emphasis added.) Section 1233(a) provides that "gain or loss from the

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rehearing in the Court of Appeals, which was denied. (R. Vol. II, pp. 22–23). Moreover, the record does not reveal the amounts paid during the taxable years; it does appear that taxpayer has been allowed a deduction of $1,694.25 for such amounts in computing the deficiencies in issue. Notice of Deficiency, p. 3, par. (e), Ex. A to Petition in Tax Court.

[2] The nature of "put" and "call" stock options, and the manner they are written by the optionor and exercised by the optionee, are described in the opinion below (Pet. A 1–2).

short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property * * * used to close the short sale constitutes a capital asset in the hands of the taxpayer".

As the court below pointed out (Pet. A 8-9), the taxpayer's short sales were "entirely divorced from his put and call writing". His short positions were not part of his business of writing call options. They rather represented separate transactions that were not required by the exercise of the calls, as his behavior on 96 of the 122 calls demonstrates. Thus such transactions did not involve goods "held primarily for sale to customers in the ordinary course of his trade or business" of writing options. The taxpayer was a trader, not a dealer, in the securities sold short, and therefore was not entitled to deduct the short sales losses as ordinary losses. See *Mirro-Dynamics Corp.* v. *United States,* 374 F. 2d 14 (C.A. 9), 1967, petition for writ of certiorari filed July 13, 1967, No. 357, this Term; *Commissioner* v. *Burnett,* 118 F. 2d 659 (C.A. 5); *Faroll* v. *Jarecki,* 231 F. 2d 281 (C.A. 7), certiorari denied, 352 U.S. 830; 3B Mertens, *Law of Federal Income Taxation* (Rev.) Section 22:153, p. 937; H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 22. Accordingly, the securities sold short were capital assets as defined in 1954 Code Section 1221(1), and the losses resulting from the short sales were capital losses under Section 1233(a).

2. There is no conflict with any decision of this Court or of any court of appeals. Indeed, this is the first case to present the issue here involved, and it

turns on its own facts. *Williamson* v. *Commissioner*, 201 F. 2d 564 (C.A. 4), certiorari denied, 345 U.S. 970, the lone appellate court case upon which the taxpayer relies for conflict, dealt with different facts and a different issue. It did not involve options to buy or sell, nor short sales by an optionor, as does this case. There, immediate sales and deliveries of cotton were made, the price to remain open for an agreed period during which the seller might "call" the price at the market price on any day. The word "call" in *Williamson* referred only to the determination of the price to be paid for the cotton, and not to any option.

3. This case lacks sufficient importance to warrant further review. Sales pursuant to the exercise of call options represent an insignificant portion of the total transactions in securities. See SEC Report on Put and Call Options 54, 63 (1961). Furthermore, the practice of the taxpayer in writing options without owning the stocks, and consequently selling short, deviated from the general practice of option writers. *Id.* at 5, 6, 56–57.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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